

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

ANNUAL COMPLIANCE REVIEW, 2013

Docket No. ACR2013

RESPONSE OF THE UNITED STATES POSTAL SERVICE TO  
QUESTION 1 OF CHAIRMAN'S INFORMATION REQUEST NO. 11

The United States Postal Service hereby provides its response to the above-listed question of Chairman's Information Request No. 11, issued on February 28, 2014. Each question is stated verbatim and followed by the response.

Respectfully submitted,

UNITED STATES POSTAL SERVICE

By its attorneys:

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March 6, 2014

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1. The table below is based on data from Library references USPS-FY12-13 and USPS-FY13-13. It shows total avoided dropship cost per pound by shape and entry point.

Total Dropship Avoided Cost Per Pound by Shape FY 2012 and FY 2013				
	FY 2012	FY 2013	Difference	Percentage
	(1)	(2)	(3)=(2)-(1)	(3)/(1)
<b>Letters</b>				
DDU	\$0.439	\$0.478	\$0.039	8.9%
DSCF	\$0.355	\$0.395	\$0.040	11.2%
DNDC	\$0.284	\$0.315	\$0.030	10.7%
<b>Flats</b>				
DDU	\$0.283	\$0.265	-\$0.018	-6.3%
DSCF	\$0.236	\$0.216	-\$0.020	-8.6%
DNDC	\$0.206	\$0.185	-\$0.022	-10.4%
<b>Parcels</b>				
DDU	\$2.196	\$11.415	\$9.219	419.9%
DSCF	\$1.997	\$11.069	\$9.072	454.3%
DNDC	\$1.513	\$8.985	\$7.472	493.8%
<b>Average</b>				
DDU	\$0.361	\$0.367	\$0.006	1.6%
DSCF	\$0.300	\$0.306	\$0.005	1.8%
DNDC	\$0.251	\$0.252	\$0.002	0.7%

The avoided dropship cost per pound increased significantly for parcels between FY 2012 and FY 2013. This increase also reduced the passthrough of the avoided cost by entry to less than 6 percent. The average avoided cost per pound across shape increased less than 2.0 percent for each entry point, while the unit avoided dropship costs within shape by entry point exhibited more volatility. A review of the library reference shows that the proximate cause of this aberration is a substantial reduction in the number of parcels. However, assuming nothing else changed, an across-the-board reduction in the number of parcels should cause a corresponding reduction in volume variable cost, which should leave the unit costs for parcels unchanged. This would seem to be borne out by the minimal year-to-year change in the average cost per pound across shape. This suggests that there may be a problem in the model or the input data.

- a. Please explain the reason for the change in the cost per pound for parcels and the other shapes.
  - i. If something in the architecture of the library reference is causing the apparent anomalous results or if there are anomalies in the input data, please explain what steps the Postal Service will take to correct the library reference so that it produces accurate costs per pound.

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- ii. If the change is due to an increase in handling or other costs, please explain what operational changes have occurred that have led to these increases.
- b. Please discuss the ramifications for the Postal Service and mailers of pricing incentives for parcel dropship discounts based on passthroughs less than 6 percent.

**RESPONSE:**

a.(i) The Standard Mail parcel destination entry cost avoidance estimates calculated in USPS-FY13-13 rely on the Commission-approved cost methodology in which the parcel cost avoidance estimates are calculated by subtracting the letter and flat cost avoidance estimates from the total Standard Mail (all shapes) cost avoidance estimates. This methodology has historically been used because annual mail characteristics data are available for Standard Mail letters and flats, but are not available for Standard Mail parcels. The underlying cause for the anomalous FY 2013 Standard Mail parcel cost avoidance estimates is unknown at this time. As the question correctly points out, the parcel volumes decreased significantly from FY 2012 to FY 2013 as a result of the Standard Commercial price categories being reclassified as Lightweight Parcel Select price categories. It is therefore possible that the methodology breaks down for smaller parcel volumes. The Postal Service is currently investigating the use of an alternative methodology for Standard Mail parcels in which a mail characteristics profile is developed using data from the USPS-FY13-12 Standard Mail parcel mail processing cost model.

a. (ii) There are no known operational changes that would have affected the parcel cost avoidance estimates to such a degree.

b. The Postal Service does not believe that there are any immediate ramifications for the Postal Service or mailers of the low passthroughs for Standard Mail

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parcel dropship discounts. While the cost avoidance estimate has increased substantially, the price incentive for mailers deciding whether to perform the worksharing has not changed at all. The Postal Service is still offering the same amount of financial incentive for dropshipping the parcels, so the financial decision whether to dropship or not has not changed for the mailer. The mailer still gets the same discount and, in all likelihood, still has the same level of costs to consider when making the decision. The only changes are the Postal Service's reported cost estimates, and the calculated passthrough percentage.

In future price changes, the Postal Service will evaluate, based on its operational requirements, whether these discounts provide appropriate pricing signals to mailers. It should be noted that the current cost avoidance estimates between \$9 and \$11 are significantly larger than the average revenue per piece for this product. Also, given the fact that we are dealing with relatively small volumes, the trend of increasing cost avoidance estimates may reverse itself abruptly and move in the opposite direction. Finally, the Postal Service notes that nearly 3/4ths of Standard Mail parcels are dropshipped, even with what appear to be the low passthroughs based on the current cost avoidance estimates.